

Aqua America, Inc. is a publicly traded water and wastewater utility holding company with operating subsidiaries serving approximately three million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana, and Virginia. It has recently purchased Peoples, a natural gas distribution utility, which will diversify Aqua America's income.

## Analyst's Notes

Analysis by Jacob Kilstein, CFA, and Justin Giacobbe, June 4, 2019

**ARGUS RATING: BUY**

- Raising target by \$2 to \$43 on relative valuation
- WTR shares trade at 27.1-times our 2019 EPS estimate, below the peer average P/E of 29.5. Our revised target values the stock in line with peers, which makes sense given WTR's above-average profitability.
- We think that Aqua America will continue to provide shareholders with solid risk-adjusted returns as it stands to benefit from an expected investment of more than \$700 billion in the nation's water and wastewater infrastructure over the next two decades.
- On May 2, Aqua America reported 1Q19 adjusted income of \$50 million, a 2% decline from 1Q18, partly due to higher operating and maintenance expenses. EPS of \$0.28 missed our estimate of \$0.29 and the consensus of \$0.30.
- In October, the company announced that it would acquire Peoples, a natural gas distribution utility, for \$4.3 billion in cash. The acquisition will diversify the company away from water distribution and is expected to close mid-2019.

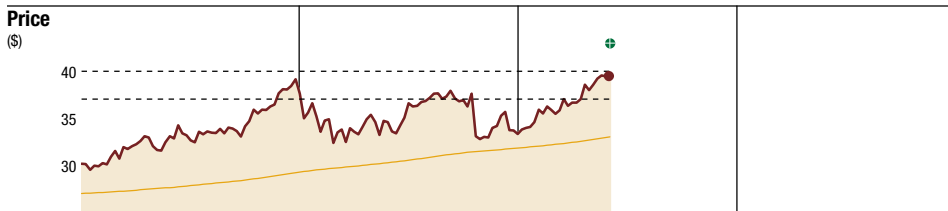
## INVESTMENT THESIS

BUY-rated Aqua America Inc. (NYSE: WTR) has a solid business model, a history of steady earnings growth, and a growing dividend. We think the company will continue to provide shareholders with solid risk-adjusted returns as it stands to benefit from an expected investment of more than \$700 billion in the nation's water and wastewater infrastructure recommended by the EPA over the next two decades. The company expects to grow its customer base not only through acquisitions but also organically, as it is well positioned in states such as North Carolina and Texas, where population growth is above the national average. The company also benefits from an experienced management team and balanced rate regulation. Lastly, we like the company's consistent earnings and rising dividend. We are increasing our 12-month price target to \$43 from \$41, which values the stock's P/E in line with its less profitable peers.

## RECENT DEVELOPMENTS

### Market Data Pricing reflects previous trading week's closing price.

— 200-Day Moving Average — Target Price: \$43.00 — 52 Week High: \$40.08 — 52 Week Low: \$37.14 — Closed at \$39.54 on 5/31



Rating		BUY		HOLD		SELL	
EPS (\$)							
Quarterly	Annual	2017	2018	2019	2020	2017	2018
0.28	1.36	0.28	0.37	0.44	0.31	0.28	0.40
0.34		0.46	0.31	0.30	0.42	0.51	0.34
0.43		0.30	0.42	0.51	0.34		
0.32							
Revenue (\$ in Mil.)							
Quarterly	Annual	2017	2018	2019	2020	2017	2018
187.8	809.5	203.4	215.0	203.3	194.3	212.0	226.1
203.4		205.8	201.1	224.7	247.6	222.2	214.2
215.0		214.2	237.1	255.0	235.5		
203.3							
FY ends Dec 31							
2017	2018	2019	2020	2017	2018	2019	2020

## Argus Recommendations

**Twelve Month Rating** SELL HOLD BUY

**Five Year Rating** SELL HOLD BUY

**Sector Rating** Under Weight Market Weight Over Weight

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 65% Buy, 34% Hold, 1% Sell.

## Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

### Market Overview

Price	\$39.82
Target Price	\$43.00
52 Week Price Range	\$32.09 to \$40.08
Shares Outstanding	215.74 Million
Dividend	\$0.88

### Sector Overview

Sector	Utility
Sector Rating	UNDER WEIGHT
Total % of S&P 500 Market Cap.	3.00%

### Financial Strength

Financial Strength Rating	MEDIUM
Debt/Capital Ratio	56.1%
Return on Equity	13.1%
Net Margin	18.7%
Payout Ratio	0.62
Current Ratio	0.37
Revenue	\$844.88 Million
After-Tax Income	\$158.07 Million

### Valuation

Current FY P/E	27.27
Prior FY P/E	28.44
Price/Sales	10.17
Price/Book	3.56
Book Value/Share	\$11.17
Market Capitalization	\$8.59 Billion

### Forecasted Growth

1 Year EPS Growth Forecast	4.29%
5 Year EPS Growth Forecast	9.00%
1 Year Dividend Growth Forecast	7.06%

### Risk

Beta	0.62
Institutional Ownership	48.14%

## Analyst's Notes...Continued

WTR shares have outperformed the S&P MidCap 400 over the last quarter, rising 9% compared to a 3% loss for the index. The shares have also outperformed over the past year, rising 13%, compared to a gain of less than 1% for the S&P MidCap 400 and a loss of 6% for the index. WTR shares have a beta of 0.62, in line with peers.

On May 2, Aqua America reported 1Q net income of \$17 million or \$0.09 per share, compared to \$51 million or \$0.29 per share in the prior-year period. The decrease was driven by losses on interest rate swaps and expenses related to WTR's acquisition of Peoples, a natural gas distribution utility. Adjusted income fell 2% to \$50 million, or \$0.28 per share, which missed our estimate of \$0.29 and the consensus forecast of \$0.30. Revenue rose 4% to \$201 million, below our estimate of \$202 million but in line with the consensus.

Operations and maintenance expenses rose 7% to \$79 million. As such, the operating margin narrowed to 33.5% from 35.7% in 1Q18.

Along with the 1Q earnings release, management reiterated its 2019 EPS guidance of \$1.45-\$1.50, excluding transaction costs for the Peoples acquisition. Management's guidance assumes total customer growth of 2.0%-3.0%, in line with last year, and \$550 million in capital spending. Management expects to spend \$1.4 billion on capital projects through 2021.

In October, the company announced that it would acquire Peoples, a natural gas distribution utility, for \$4.2 billion in cash,

including the assumption of \$1.3 billion in debt. Peoples serves about 740,000 customers in Pennsylvania, Kentucky, and West Virginia. The combined company's stock will trade under a new name. Management expects earnings accretion in the first full year after the closing and looks for 7% annual rate base growth in its water business and 8%-10% in natural gas through 2021. The Peoples deal is expected to close in mid-2019. Aqua America's revenue will still be 99% regulated following the acquisition.

WTR expects to spend an additional \$50 million on system upgrades over the next 10 years. It expects to add 16,750 customers through the end of 2019 through additional acquisitions.

## EARNINGS & GROWTH ANALYSIS

To date in 2019, WTR obtained rate increases or imposed surcharges in Ohio, Illinois and Pennsylvania, providing \$5 million in revenue. Pending rate cases in New Jersey, Ohio, and North Carolina are seeking an additional \$6 million of revenue.

During 1Q19, the company completed three acquisitions of water and wastewater systems, which added 572 customer connections. WTR financed those acquisitions with debt.

We are maintaining our 2019 EPS estimate of \$1.46, which implies 4% growth and assumes higher rates in the company's regulated operations. We are also maintaining our 2020 estimate of \$1.57.

We think the company will control costs and improve the

## Growth & Valuation Analysis

### GROWTH ANALYSIS

(\$ in Millions, except per share data)

	2014	2015	2016	2017	2018
Revenue	780	814	820	810	838
COGS	289	309	305	287	308
Gross Profit	491	505	515	522	530
SG&A	—	—	—	—	—
R&D	—	—	—	—	—
Operating Income	314	321	326	329	323
Interest Expense	76	77	81	88	99
Pretax Income	239	217	255	257	178
Income Taxes	25	15	21	17	-14
Tax Rate (%)	11	7	8	7	—
Net Income	233	202	234	240	192
Diluted Shares Outstanding	178	178	178	178	178
EPS	1.31	1.14	1.32	1.35	1.08
Dividend	0.63	0.69	0.74	0.79	0.85

### GROWTH RATES (%)

Revenue	2.4	4.4	0.7	-1.3	3.5
Operating Income	4.2	2.1	3.8	0.2	-3.2
Net Income	5.4	-13.5	16.1	2.4	-19.9
EPS	4.3	-5.0	15.8	2.3	-20.0
Dividend	8.6	8.2	7.7	7.2	7.0
Sustainable Growth Rate	6.9	6.6	4.7	5.2	5.1

### VALUATION ANALYSIS

Price: High	\$28.22	\$31.09	\$35.83	\$39.55	\$39.38
Price: Low	\$22.40	\$24.40	\$28.03	\$29.41	\$32.09
Price/Sales: High-Low	6.4 - 5.1	6.8 - 5.3	7.8 - 6.1	8.7 - 6.5	8.4 - 6.8
P/E: High-Low	21.5 - 17.1	27.3 - 21.4	27.1 - 21.2	29.3 - 21.8	36.5 - 29.7
Price/Cash Flow: High-Low	13.8 - 11.0	14.9 - 11.7	16.9 - 13.2	18.1 - 13.5	18.0 - 14.7

## Financial & Risk Analysis

### FINANCIAL STRENGTH

	2016	2017	2018
Cash (\$ in Millions)	4	4	4
Working Capital (\$ in Millions)	-173	-153	-252
Current Ratio	0.43	0.46	0.37
LT Debt/Equity Ratio (%)	93.9	102.6	119.4
Total Debt/Equity Ratio (%)	103.1	109.7	127.8

### RATIOS (%)

Gross Profit Margin	63.8	65.1	63.2
Operating Margin	40.7	41.2	38.6
Net Margin	28.6	29.6	22.9
Return On Assets	3.9	3.8	2.9
Return On Equity	13.1	12.6	9.7

### RISK ANALYSIS

Cash Cycle (days)	-21.3	-22.0	-33.7
Cash Flow/Cap Ex	1.0	0.8	0.7
Oper. Income/Int. Exp. (ratio)	—	—	—
Payout Ratio	53.8	60.4	58.5

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## Analyst's Notes...Continued

efficiency of acquired assets, invest in infrastructure projects, and grow its customer base both organically and through acquisitions. The company plans to invest \$550 million in infrastructure in 2019, following subsequent record investments of \$478 million in 2017 and \$500 million in 2018. WTR will use the funds to replace pipes, enhance water quality, and strengthen service reliability.

### FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Aqua America is Medium, the midpoint on our five-point scale. Our three main criteria include debt levels, fixed-cost coverage and profitability.

The company's total debt/total capitalization ratio was 57% at the end of 1Q, above the peer average of 55%. EBITDA covered interest expense by a factor of 5.5 in 1Q, below the peer average of 5.7. The 1Q adjusted net margin of 24.6% was well above the peer average of 12.3%. As of May 2, WTR had \$4 million in cash and \$2.7 billion in debt.

WTR pays a quarterly dividend of \$0.219, or \$0.876 annually, for a yield of about 2.3%, above the peer average of 1.8%. WTR has grown its dividend at a 7.6% average annual rate over the last five years. It has paid consecutive quarterly dividends for 74 years, and has raised the dividend 28 times in the past 27 years. Our 2019 dividend estimate is \$0.91 per share and our 2020 estimate is \$0.99.

### MANAGEMENT & RISKS

Christopher Franklin has been CEO since July 2015. Mr.

Franklin is a 25-year veteran of the company, and previously served as president and chief operating officer of its regulated operations.

The U.S. water industry is fragmented, with more than 53,000 individual water systems. Many of these systems cannot afford to meet the EPA's increasingly stringent standards, and have put themselves up for sale. In fact, several companies have sought to be acquired by Aqua America. The range of acquisition targets has also grown as cash-strapped municipalities look to monetize their utility assets. We believe that WTR will be able to acquire additional municipal water systems in the coming years at attractive prices.

Key risks for water utilities include the effect of adverse weather on revenues, regulatory issues (especially related to construction cost recovery), and potential environmental and safety-related liabilities. In addition, the utility's heavy capital needs create ongoing liquidity risk.

### COMPANY DESCRIPTION

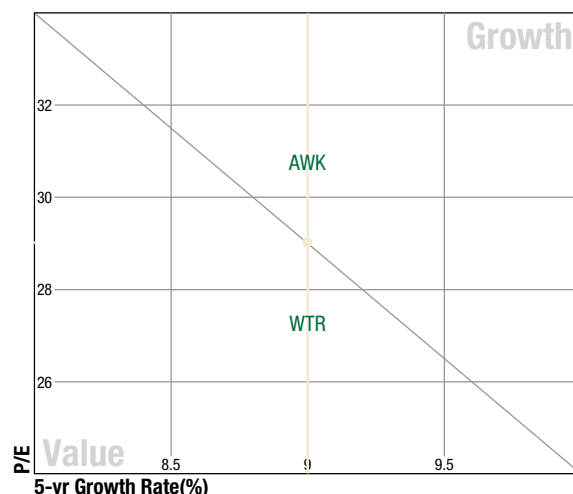
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### VALUATION

## Peer & Industry Analysis

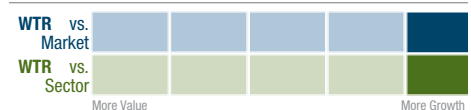
The graphics in this section are designed to allow investors to compare WTR versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

- The scatterplot shows how WTR stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.
- The table builds on the scatterplot by displaying more financial information.
- The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how WTR might fit into or modify a diversified portfolio.

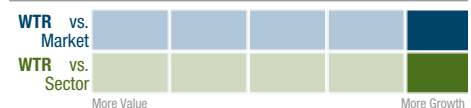


Ticker	Company	Market Cap (\$ in Millions)	5-yr Growth Rate (%)	Current FY P/E	Net Margin (%)	1-yr EPS Growth (%)	Argus Rating
AWK	American Water Works Co. Inc.	20,547	9.0	30.8	16.4	7.0	BUY
WTR	Aqua America Inc.	8,591	9.0	27.3	18.7	7.5	BUY
Peer Average		14,569	9.0	29.0	17.6	7.3	

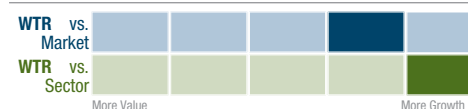
### P/E



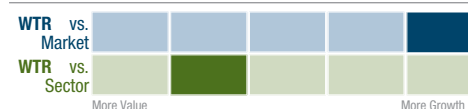
### Price/Sales



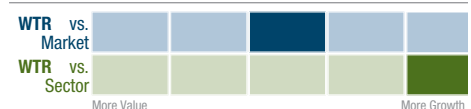
### Price/Book



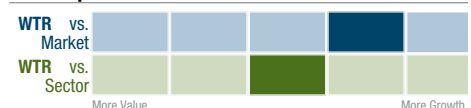
### PEG



### 5 Year Growth



### Debt/Capital



**Analyst's Notes**...Continued

WTR shares appear attractively valued at current prices near \$39. Over the past 52 weeks, the shares have traded between \$32 and \$40.

WTR shares are trading at a discount to peers on a P/E basis, but at a premium based on price/book and price/sales, which we feel is justified by the company's solid long-term fundamentals. The shares trade at 27.1-times our 2019 EPS estimate which is below the peer average of 29.5. In our view, the company's financial strength, favorable risk profile, visible forward earnings stream and attractive integrated structure make WTR a compelling investment. We are increasing our 12-month price target to \$43, which values the stock's P/E in line with less profitable peers.

On June 4, BUY-rated WTR closed at \$39.82, down \$0.22.

## About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

### THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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